

Message Text

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ACTION ARA-10

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-07 FRB-03

INR-07 NSAE-00 TRSE-00 XMB-02 OPIC-03 SP-02 CIEP-01

LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04 CEA-01 L-02

H-02 FEA-01 /077 W

----- 108646

R 111934Z APR 75

FM AMEMBASSY MONTEVIDEO

TO SECSTATE WASHDC 8641

INFO AMEMBASSY BUENOS AIRES

AMEMBASSY BRASILIA

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E.O. 11652: N/A

TAGS: ECON, UY

SUBJECT: GOU ECONOMIC REFORMS

REF: A) MVD 601

B) MVD 796

C) MVD 3474 (NOV. 27,1974)

1. SUMMARY: ON EVENING OF APRIL 9, GOU REVEALED AN IMPORTANT SERIES OF ECONOMIC REFORM MEASURES. THESE INCLUDE A 10.4 PER CENT DEVALUATION OF COMMERCIAL RATE, WAGE AND PRICE INCREASES AND A NUMBER OF STEPS TO LIBERALIZE AND REDUCE THE COST OF IMPORTS. HOWEVER, A MINIMUM 35 PER CENT PRIOR DEPOSIT FOR 150-180 DAYS WILL BE REQUIRED ON ALMOST ALL COMMERCIAL IMPORTS. THESE MEASURES CONSTITUTE PART OF THE PACKAGE AGREED TO WITH THE IMF IN URUGUAY'S STANDBY NEGOTIATIONS. END SUMMARY.

2. DEVALUATION-A DEVALUATION OF 10.4 PER CENT IN THE COMMERCIAL EXCHANGE RATE, UNDER WHICH ALL TRADE TRANSACTIONS TAKE PLACE, PUTS THIS RATE AT US \$1 EQUALS UY \$2,300. THIS IS JUST 3.4 PER CENT UNDER THE CURRENT FINANCIAL FX EXCHANGE RATE. AN ACCELERATED
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SERIES OF MINI DEVALUATIONS THIS YEAR HAS DEVALUED THE COMMERCIAL

RATE 40 PER CENT SO FAR, AND THE GOU ANNOUNCEMENT STATES THERE WILL NOW BE A "PAUSE" IN FURTHER MINI DEVALUATIONS. ACCORDING TO THE COMMUNIQUE, "THE DURATION OF SAID PAUSE WILL DEPEND ON THE EVOLUTION OF THE CONJUNCTION OF INTERNAL AND INTERNATIONAL PRICES AND MARKET CONDITIONS AND AT THE END OF IT WILL BE RENEWED GRADUALIST TREATMENT (I.E., BY MUNI DEVALUATIONS) AGAINST INFLATION AT A SLOWER PACE THAN IN THE IMMEDIATE PAST).

3. SALARY AND WAGE INCREASES-A UY\$30,000 PER MONTH WAGE INCREASE ACROSS THE BOARD, RETROACTIVE TO APRIL 1 FOR PRIVATE SECTOR AND EFFECTIVE MAY 1 FOR THE PUBLIC SECTOR, IS ORDERED. WHILE THIS INCREASE IS MINIMAL FOR MIDDLE AND UPPER-INCOME GROUPS, IT REPRESENTS PERHAPS A 10 PER CENT INCREASE FOR LOWER PAID WAGE EARNERS AND A 21 PER CENT INCREASE IN THE MINIMUM WAGE. THE GOU ANNOUNCEMENT STATES, "IT IS PROJECTED THAT THE DURATION OF THE NEW SALARY LEVELS WILL BE PROLONGED FOR A PERIOD SUBSTANTIALLY GREATER THAN IN THE RECENT PAST (COMMENT: MOST RECENT GOU-ORDERED SALARY INCREASE WAS IN FEBRUARY), OWING TO THE ABATEMENT OF INFLATIONARY RHYTHM IT IS HOPED TO OBTAIN". OPP DIRECTOR INDICATED TO US THAT NO FURTHER INCREASES ARE PROJECTED THIS YEAR. HOWEVER, CHRISTMAS BONUS WILL BE PAID IN TWO PARTS, HALF IN JUNE AND HALF IN NOVEMBER.

4. PRICE INCREASES-THE GOVERNMENT ORDERED INCREASES IN RETAIL SALE PRICES AVERAGING 17 PER CENT FOR THE STATE PETROLEUM MONOPOLY EFFECTIVE IMMEDIATELY AND AN AVERAGE 10 PERCENT INCREASE IN RATES OF THE OTHER STATE ENTITIES, INCLUDING TELEPHONE, RAILROADS AND ELECTRIC POWER, EFFECTIVE MAY 1. COPRIN, THE GOU PRICE CONTROL AGENCY, IS DIRECTED TO MAKE NECESSARY ADJUSTMENTS IN OTHER RETAIL PRICES TO ABSORB THE SALARY INCREASE. REGARDING THE EFFECT OF DEVALUATION ON INTERNAL PRICES, THE GOVERNMENT EXPECTS THE DEVALUATION WILL BE COMPENSATED BY THE REDUCTION OF COSTS IN IMPORTS RESULTING FROM BOTH INTERNATIONAL PRICE DECLINES AND THE NEW IMPORT LIBERALIZATION MEASURES. THE GOU COMMUNIQUE ADDS THAT COPRIN WILL SOON ANNOUNCE CONTROL MEASURES THAT WILL BE ADOPTED TO COMPLY WITH TODAY'S DECISIONS. (COMMENT: THE SALARY WAGE AND PRICE INCREASES ARE INTENDED TO SET A BASE FOR THE STABILIZATION PROGRAM, AGREED TO WITH THE IMF, TO REDUCE INFLATION TO 27-30 PERCENT ON APRIL TO MARCH ANNUAL BASIS. IT IS WIDELY EXPECTED THAT COPRIN WILL ENFORCE A NEW PRICE FREEZE FOLLOWING IMPLEMENTATION OF THESE LIMITED OFFICIAL USE

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INCREASES).

5. IMPORT LIBERALIZATION AND PRIOR DEPOSITS-A VERY SIGNIFICANT SERIES OF MEASURES EFFECT IMPORTS STARTING APRIL 14. ACCORDING TO A CENTRAL BANK (CB) CIRCULAR ISSUED TODAY, ALMOST ALL COMMERCIAL IMPORTS WILL HAVE TO BE COVERED BY A 35 PERCENT OF CIF, 6-MONTH, NON-INTEREST BEARING PESO DEPOSIT WITH THE CB. PREVIOUSLY, THE SYSTEM OF PRIOR DEPOSITS, AT MUCH HIGHER RATES, HAD ONLY APPLIED TO THOSE

FEW IMPORTS IN EXCESS OF ESTABLISHED IMPORTERS' QUOTAS. EXONERATED IMPORTS AND A FEW OTHER CATEGORIES ARE THE ONLY EXEMPTIONS FROM THE NEW PRIOR DEPOSITS. ACCORDING TO THE GOU COMMUNIQUE, THE PRESENT "CUPO" SYSTEM FOR IMPORTERS WILL BE GRADUALLY ABOLISHED SO THAT BY JUL 1, 1975 THE MAJOR PART OF IMPORTS WILL NOT BE SUBJECT TO QUOTAS. RAW MATERIALS WILL BE THE FIRST TO BE FREED, BY A CB CIRCULAR EXPECTED NEXT WEEK. FURTHERMORE, THE REQUIREMENT THAT 180 DAY FINANCING FOR IMPORTS BE OBTAINED FROM FOREIGN SOURCES WILL BE ELIMINATED BY JULY 1, AND UNTIL THEN THE CB WILL BE EMPOWERED TO WAIVE THE REQUIREMENT IN PARTICULAR CASES. THE COMMUNIQUE ALSO STATES THAT CONSULAR INVOICE CHARGES WILL BE REDUCED FROM 6 TO 4 PERCENT (SEE REF B). THE MINISTER OF ECONOMY IN CONSULTATION WITH THE RELEVANT GOVERNMENT BODIES IS DIRECTED TO "IN THE SHORTEST POSSIBLE TIME PROCEED WITH THE REDUCTION OF THE COST OF IMPORTS IN THE AREA OF TARIFF AND PORT CHARGES". IN A RELATED MEASURE, ANOTHER CB CIRCULAR REQUIRES FORWARD FOREIGN EXCHANGE SALES COVERING IMPORTS TO BE MADE DIRECTLY BY THE CB.

6. COMMENT: IN ADDITION TO THE ANTI-INFLATIONARY EFFECT OF THE REVISED SYSTEM OF PRIOR DEPOSITS, THERE ARE TWO IMPORTANT ASPECTS OF THE NEW MEASURES WHICH WILL CONSIDERABLY STRENGTHEN THE COJS CONTROL OF THE MONETARY AND CREDIT SYSTEM. PREVIOUSLY, THE BANK OF THE REPUBLIC (BOR) HAS BEEN ABLE TO EVADE, IN EFFECT, CB CONTROL OF MONETARY EMISSION THROUGH THE USE OF PRIOR DEPOSITS AND THE PROCEEDS OF FORWARD FX SALES FOR EXPANDING ITS CREDIT OPERATIONS. UNDER THE NEW SYSTEM, THESE FUNDS WILL BE STERILIZED IN THE CB AND BOR CREDIT EXPANSION WILL LARGELY DEPEND ON RE-DISCOUNT FACILITIES UNDER CB CONTROL. WE UNDERSTAND MEASURES ALONG THESE LINES ARE PART OF THE PACKAGE NEGOTIATED WITH THE IMF AND LOCAL REPRESENTATIVE OF IMF TOLD EMBOFFS HE WAS PLEASED WITH THE STEPS TAKEN. HE WAS VERY OPTIMISTIC THAT CB PRESIDENT GIL WOULD NEXT WEEK IN WASHINGTON PRESENT THE GO SIGNED LETTER OF INTENT TO THE IMF AND A STANDBY WOULD BE FORTHCOMING IN MAY. LIMITED OFFICIAL USE

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THIS IS CRUCIAL TO MIN. VEGH VILLEGAS' ECONOMIC REFORM PROGRAM, AS IT IS EXPECTED TO TRIGGER IBRD ASSISTANCE AND PERMIT RAPID AGREEMENT ON A \$110 MILLION LOAN AGAINST GOLD NOW IN FINAL NEGOTIATIONS WITH A CONSORTIUM OF FOREIGN BANKS (REF C).

7. TEXT OF THE GOU COMMUNIQUE AND RELATED CB CIRCULARS WILL FOLLOW BY AIRGRAM.

8. GDS.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: WAGES, IMPORTS, ECONOMIC REPORTS, ECONOMIC PROGRAMS, DEVALUATIONS, PRICE TRENDS
Control Number: n/a
Copy: SINGLE
Draft Date: 11 APR 1975
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: GolinoFR
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975MONTEV01190
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D750128-0184
From: MONTEVIDEO
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19750459/aaaacbzu.tel
Line Count: 164
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION ARA
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 3
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 75 MVD 601
Review Action: RELEASED, APPROVED
Review Authority: GolinoFR
Review Comment: n/a
Review Content Flags:
Review Date: 02 SEP 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <02 SEP 2003 by BoyleJA>; APPROVED <03 SEP 2003 by GolinoFR>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
05 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: GOU ECONOMIC REFORMS
TAGS: ECON, UY
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 05 JUL 2006